UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

ALBERT L. GRAY, Administrator, *et al.* Plaintiffs,	:	
vs.	:	C.A. No. 04-312-L
JEFFREY DERDERIAN, *et al.* Defendants.	:	

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' OBJECTION TO MOTION TO DISMISS MASTER COMPLAINT AGAINST ESSEX INSURANCE COMPANY

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Plaintiffs submit this Memorandum of Law in support of their Objection to the Motion to Dismiss of Essex Insurance Company under Fed.R.Civ.P. 12(b)(6).

Introduction

Defendant Essex Insurance Company has moved to dismiss this action against it pursuant to Fed.R.Civ.P. 12(b)(6). While its Memorandum of Law In Support of Motion to Dismiss Master Complaint Against Essex Insurance Company (hereinafter "Defendant's Memo") is long on characterizations of Plaintiffs' Complaint, ("purportedly acting on behalf of over 200 plaintiffs" . . . "unnumbered count" . . . "ill-defined claim"),[1] the memorandum studiously avoids Rhode Island's statutory law and caselaw establishing a public policy

[1] Plaintiff Albert A. Gray, Administrator, "purports" to act for no person other than the estate of which he is administrator. Contrary to Essex' suggestion, Plaintiffs' Complaint is not styled as a class action but, rather, contains claims by 226 plaintiff groups separately represented by eight cooperating law firms.

in favor of liability insurers' liability to third persons for negligent inspection.[2] A more straightforward approach to the issues must start with a review of Essex' role in the Station nightclub tragedy.

I. MOVANT ESSEX AND ITS RELATION TO THE TRAGIC STATION NIGHTCLUB FIRE

The following facts are known before any discovery has been undertaken:

-- Essex Insurance Company was the liability[3] insurer for Michael Derderian[4] from March 24, 2002 to March 24, 2003 under policy number 3CH 0430.

-- Highly-flammable polyurethane foam had been installed on the interior walls of the Station in June, 2000 and remained there through the fire on February 20, 2003.

-- An agent/designee of Defendant Essex, Multi-State Inspections Inc., inspected the Station on October 8, 2002, accompanied by Michael Derderian, later rendering him a written report[5] with recommendations to the insured to reduce the risk of harm to patrons; specifically, "Repair door on right side of risk as well as push bar." No mention was made of the Station's rated occupancy as a nightclub, the adequacy of exits for such rating or the highly flammable foam covering interior walls.

-- Four months after Defendant Essex' inadequate liability inspection, sparks from on-stage fireworks ignited the overlooked foam, turning the Station into an inferno within two

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[2] Plaintiffs have never asserted that "Essex is liable directly to plaintiffs [merely] as Michael Derderian's insurer," Defendant's Memo at 2, a subject to which Defendant devotes several pages of argument.

[3] Critical to Plaintiffs' Complaint is that Essex was the liability insurer for the Station nightclub's owner, rather than its fire, casualty or workers' compensation insurer. This is because of Rhode Island's statutory insurance inspection immunity scheme, discussed infra, which confers immunity upon casualty insurers but not liability insurers.

[4] While the named insured on Essex' policy is "Michael Derderian," the risk being underwritten, according to the inspection report, is clearly The Station nightclub business, which was owned by Derco, LLC.

[5] Exhibit A, attached.

minutes, killing 100 patrons and injuring at least 200 others. It was the most deadly fire in the history of Rhode Island and the fourth deadliest nightclub fire in the history of our country.

II. WHAT ESSEX IS NOT, AND WHY THIS IS IMPORTANT TO THE INSTANT MOTION

Lest there be any confusion engendered by Defendant's Memo, Essex is not an insurer being sued by a third party for alleged bad faith in claims adjusting (notwithstanding Defendant's reliance in its "absence of duty" argument upon at least five cases limited specifically to this situation).[6] Nor is Essex the Station's workers' compensation insurance carrier (three such cases are relied upon by Essex), a situation clearly distinguishable by the "exclusive remedy" provisions of Rhode Island's workers' compensation scheme. Nor, of course, is Essex a defendant in a "direct action" arising solely from negligence of its insured. (Essex relies upon six such cases.)

Rather, Essex is being sued for its own egregious negligence in inspection which resulted in a tragedy of historic proportions.[7] Plaintiffs are suing Essex, the liability insurer of Michael Derderian, under the common

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[6] The ellipses in Defendant's quote from *Auclair v. Nationwide Mut. Ins. Co.*, 505 A.2d 431 (R.I. 1986), are most telling. Defendant's Memo at 5 asserts, "The relationship between the claimant and the insurance carrier . . . is an adversary relationship *giving rise to no fiduciary obligation on the part of such insurance carrier to the claimant. Any obligation . . . runs only to the insured."* The omitted language completely distinguishes *Auclair* from the case at bar: "Any obligation to deal with settlement offers in good faith runs only to the insured." 505 A.2d at 431.

[7] The facts of Essex' involvement in the Station tragedy are far more than merely "underwriting a foolhardy risk," which was understandably described by this Court as an insufficient basis for liability in *McAleer v. Smith*, 791 F.Supp. 923 (D.R.I. 1992). The *McAleer* record was devoid of any evidence whatsoever that Lloyd's of London knew of, or participated in, use of its name in promotions (much less inspected the risk and made recommendations, like Essex here).

law of Rhode Island as set forth in Restatement, Torts, 2d, §324A; specifically, §324A(c).

III. ESSEX' DUTY TO PLAINTIFFS ARISES FROM COMMON LAW, AS SET FORTH IN RESTATEMENT, TORTS, 2D, §324A

A. The Public Policy Of Rhode Island, Embodied In Its Legislative Enactments, Supports A Duty Of Liability Insurers To Third Parties Injured As A Result Of Negligent Inspections

1. Rhode Island's "Insurance Inspection Immunity Statute" Conspicuously Omits Protection Of Liability Insurers

Given the confident tone of Defendant's Memo, it is surprising that nowhere does it mention the Rhode Island statute conferring upon insurance company-inspectors the very type of immunity Essex claims. Rhode Island General Laws Title 27, Chapter 8, Section 15 is tantalizingly titled, "Insurance Inspections." Concise and to the point, the statutory section provides:

> **§27-8-15 Insurance inspections. – The furnishing of,** or failure to furnish, **insurance inspections** or advisory services **in connection with or incidental to the issuance or renewal of a policy of property, casualty or boiler and machinery insurance shall not subject the insurer**, whether domestic or foreign, its agents, employees, or service contractors, **to liability for damages from injury, death, or loss occurring as a result of any act or omission in the course of those services**. This section shall not apply in the event the active negligence of the insurer, its agent, employee, or service contractor, created the condition that was the proximate cause of injury, death or loss.

Why might Essex shy from the above provision? The answer is that Essex is the Station's liability insurer – and because R.I.G.L. §27-8-15 by its

terms insulates issuers of property, casualty,[8] boiler and machine insurance only. That the Rhode Island General Assembly chose to confer immunity from third-party liability for negligent inspections upon all but liability insurers is instructive concerning Rhode Island's public policy in this regard. The conspicuous absence of liability insurers from Rhode Island's inspectors' immunity statute compels the conclusion that the legislature intended common law remedies to remain against them. The well-recognized maxim of statutory interpretation, *expressio unius et exclusio alterius,* tells us that if Rhode Island wanted to insulate liability insurers, it would have . . . but it has not.

Rhode Island's refusal to confer inspection immunity upon liability insurers stands to reason when one considers the close relationship between foreseeability and duty.[9] An issuer of fire or casualty insurance is concerned about risk to its insured's business and physical property. Inspections by such carriers necessarily attempt to foresee such property risks, only. An insurer of liability for personal injury to third parties, by contrast, is concerned in its inspections with hazards to third parties – in this case, patrons of the Station nightclub.

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[8] Rhode Island's General Laws clearly divide Title 27, pertaining to all insurance matters, into chapters pertaining to "Liability Insurance" (ch. 7) and "Casualty Insurance" (ch. 8). The provision in question, Title 27, Chapter 8, Section 15 falls within the "Casualty" chapter.

[9] "It is the likelihood of injury to another that gives rise to the duty to exercise due care . . . The foreseeability of injury is the touchstone of the quality of the act as negligent. This is the basis of liability." Dooley, James A., Modern Tort Law, §3.10.

It is entirely foreseeable that a negligently performed inspection of possible hazards to third parties will result in injury to those very third parties. It is, therefore, entirely reasonable that Rhode Island has chosen not to insulate liability insurers from liability to the same third parties whose harm its inspections are intended to avoid. This is particularly true where, as here, it is likely that the insured (Michael Derderian, in his capacity as owner of the Station nightclub) relied on the results and written recommendations[10] of the inspection, which was not only known to him but conducted in his presence.

2. The Workers' Compensation "Exclusive Remedy" Provision Is Completely Distinguishable

Defendant's Memo makes much of Rhode Island's conferring immunity on workers' compensation insurers who negligently inspect their insureds' workplaces, citing *Mustapha v. Liberty Mutual Insurance Co.*, 268 F.Supp. 890 (D.R.I. 1967). However, as explained by the interpretative caselaw, Rhode Island workers' compensation scheme is a comprehensive program which provides prompt, no-fault benefit to employees who are injured on the job. The flip side of this prompt, no-fault recovery is that, by statute, such benefits are the employee's exclusive remedy against his employer, however

[10] The twin notions of foreseeability and reliance by the insured, both present here in the context of a liability insurance inspection followed by written recommendations to the insured, dovetail with Restatement Torts 2d Section 423A(c), discussed, *infra*. That section speaks of liability when one undertakes to render services for another "which he should recognize as necessary for the protection of a third person" where "the harm is suffered because of the reliance of the other . . . upon the undertaking."

negligent that employer might be. In this regard, Rhode Island treats the employer and its workers' compensation insurer as one, giving the latter the benefit of the "exclusive remedy" provision. As this Court explained in *Whitmarsh v. Durastone Co.,* 122 F.Supp. 806, 810 (D.R.I. 1954),

> The Workmen's Compensation Act of Rhode Island provided a new system of compensation for personal injuries to employees arising out of and in the course of their employment. Provision is made therein for definite compensation to the employee or if death results from the injury to his dependents. . . . Its purpose was to provide a simple and expeditious procedure by which an employee or his dependents would receive from his employer compensation for injuries sustained in industrial accidents. It abolished the employee's right to maintain a common law action for his injuries against his employer who in turn was deprived of certain common law defenses previously available to him. (Citations omitted.)

As further explained in *Mustapha, supra,*

> It is clear a reading of the act shows that the legislature did not specifically grant immunity to a compensation insurer from being amenable to suit as a third-party tortfeasor, but numerous provisions equating the workmen's compensation insurer with the employer does negative an intent to hold it, the insurer, liable to suit as a third party. . . . Throughout the whole context of the act, the words "employer" and "insurer" are used interchangeably, thus denoting an equating of the two.

268 F.Supp. at 892-93 (emphasis supplied). Quoting from a similarly-decided Florida case, *Mustapha* continues, 268 F.Supp. at 895,

> The *ratio decidendi* in all the cases was that since the acts [like Rhode Island's] expressly charged the carriers with the [strict] liability of an employer, the carrier was likewise entitled to the immunities of an employer (emphasis supplied).

This rationale for workers' compensation insurer immunity was embraced by the Rhode Island Supreme Court itself in *Cianci v. Nationwide Insurance Co.*, 659 A.2d 662 (R.I. 1995), explaining:

> Under the Rhode Island Workers' Compensation Act an insured employee is insured timely and certain, though limited, compensation. In exchange he or she gives up the right to pursue an action at law that, although potentially more remunerative, is likely to be protracted and may well be unsuccessful. . . . Workers' compensation benefits are meant as full compensation for any loss or harm that is alleged to have been caused by any entity to which immunity from suit is extended under §28-29-20." [Quoting *DiQuinzio v. Panciera Lease Co.*, 612 A.2d 40, 42 (R.I. 1992)] An employee covered under the act has no common-law right of action against the insurer because the act expressly addresses such claims and thus immunizes the carrier from liability against any common law suit.

659 A.2d at 669-70 (emphasis supplied).

By no means can *Mustapha* and *Cianci*, *supra*, be read as heralding a broad public policy of immunizing insurers of any stripe against liability to persons foreseeably exposed to hazard by the insurers' own negligently performed inspections. Rather, those cases reflect a legislative decision to immunize one cog in a comprehensive no-fault workers' compensation machine – a far cry from the case at bar.

B. Rhode Island Common Law Recognizes Third-Party Claims Arising From Negligent Inspections

1. The Rhode Island Supreme And Superior Courts Have Embraced Restatement 2d Torts §324A In Similar Contexts

As early as 1967 the Rhode Island Supreme Court in *Buszta v. Souther*, 102 R.I. 609, 232 A.2d 396 (1967), embraced "the modern view,

as expressed in Restatement, Torts, 2d §324A" to impose liability for negligent inspection of an automobile, resulting in injury to a subsequent third-party user without privity to the inspector. In *Buszta* an employer took his automobile to a service station to have it inspected for safety. After the inspection an employee of the automobile owner was injured, allegedly as a result of a defective condition of the car's brakes. The inspector, like Essex in the instant case, claimed complete absence of duty to the injured third party who lacked privity. The Supreme Court rejected that argument, however, explaining,

> It is our opinion that where a party to a contract[11] undertakes to render a service or perform an obligation and the circumstances involved in the undertaking make it clear that there is an obvious and unreasonable risk of harm or injury to outsiders if he does not exercise due care in fulfilling the contract, an obligation arises by law and is imposed upon the contracting party to exercise that amount of care and skill reasonably required by the facts and commensurate with the risk presented. Prosser, Torts (2d Ed.), §85, p. 514; *Hudson v. Moonier* (CCA 8th), 102 F.2d 96 (cert. denied 1939, 307 U.S. 639, 59 S.Ct. 1037, 83 L.Ed. 1520); *Zatkin v. Katz*, 126 Conn. 445, 11 A.2d 843; *Bollin v. Elevator Construction and Repair Co.*, 361 Pa. 7, 63 A.2d 19, 6 A.L.R. 2d 277; *Van Winkle v. American Steam Boiler Co.*, 52 N.J.L. 240, 19 A. 472.

102 R.I. at 613-14, 232 A.2d at 399. The *Buszta* opinion continues,

> This rule is in accord with the modern view as expressed in the Restatement, Torts, 2d, §324A. It properly places the burden of making financial recompense upon the party whose negligence caused the injury.

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[11] We readily acknowledge that *Buszta* involved a contract for inspection, alone. However, here the inspection was undertaken as part of a contract of insurance. The same principles of foreseeability and reliance which underlie §324A apply with equal force in the case at bar.

Id. In *Buszta* the Rhode Island Supreme Court relied upon §324A to disallow "privity . . . as an immunizing agent which it would be if we were to countenance its invocation by defendant here." 102 R.I. at 616, 232 A.2d at 400.

In a more recent opinion, *Dixon v. Royal Cab, Inc.*, 1988 WL 1045146 (R.I. Super.), the Rhode Island Superior Court undertook a §324A analysis to determine whether an allegedly negligent attorney had undertaken to render services to a third person which he should have recognized as necessary for the protection of the property of that third person. The Superior Court, quoting §324A, found that there had been no reliance upon the attorney's undertaking; thus, "tested by the standards of §324A and the law of jurisdictions imposing attorney liability notwithstanding the absence of privity, Gunning owed no duty to American . . ." By contrast here, Essex Insurance Company conducted the faulty inspection in the presence of its insured, notified the latter of its (woefully incomplete) "recommendations" and, quite likely, the insured relied upon these recommendations.[12]

Thus, both the Rhode Island Supreme Court and Superior Courts have embraced Restatement 2d Torts §324A as, respectively, the "modern view"

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[12] Discovery of Michael and Jeffrey Derderian, Essex' inspector and Essex itself has not yet commenced. It is likely that discovery will flesh out the insured's reliance on the written recommendations of an inspection at which he was personally present. In any event, the standard of review for 12(b)(6) motions to dismiss, discussed more fully *infra*, is whether it appears "clear beyond doubt that plaintiffs cannot conceivably prove a set of facts in support of their claim which would entitle them to relief." 1A *Barron and Holtzoff*, §356, p. 363, citing *Conley v. Gibson*, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed. 2d 80 (1957).

and a template for analysis of third-party liability. The Restatement section lauded by those courts bears closer scrutiny:

> §324A. -- Liability To Third Person For Negligent Performance Of Undertaking
>
> One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to [perform][13] his undertaking, if
>
> (a) his failure to exercise reasonable care increases the risk of such harm, or
> (b) he has undertaken to perform a duty owed by the other to the third person, or
> (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.
>
> It is important to note that liability under §324A may be established

under any <u>one</u> of its alternative subsections, (a), (b) or (c). Defendant's Memo claims unfulfilled "requirements"[14] of §324A in the instant case and cites caselaw in support of such alleged "requirements" without explaining their limitation to one of the alternative subsections of §324A; i.e., subsection (a) may require actual increase to the risk of harm occasioned by

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[13] The reporter for this edition of the Restatement has verified that the word "protect" which appears here is a typographical error and should read "perform." *Hill v. U.S. Fidelity and Guaranty Co.*, 428 F.2d 112 (5th Cir. 1970), cert. denied 400 U.S. 1008, 27 L.Ed. 2d 621, 91 S.Ct. 564 (1971), fn. 5.

[14] Essex' Memorandum speaks of the "requirement" that Essex have "increased the risk of harm", Defendant's Memo at 10, and "undertaken to perform a duty" owed by the insured, Defendant's Memo at 11, which "wholly supplanted" the insured's duty. While such considerations may apply to claims under §324A (a) or (b), they, and the Restatement Comments cited, have no bearing on actions such as Plaintiffs' claim, which clearly sounds under subsection (c).

the Defendant's failure. Subsection (b) may require an intent to completely supplant the insured's duty.

However, here liability is premised on subsection (c) alone, thus rendering Defendant's arguments and citations misleadingly inapposite. Stripped to their essence, the provisions of §324A which control the case at bar read:

> One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person . . . is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to [perform] his undertaking, if
>
> * * *
>
> (c) the harm is suffered because of reliance of the other . . . person upon the undertaking.

2. Essex Undertook To Render Services Which It Should Have Recognized As Necessary For The Protection Of Third Persons, Under §324A

Essex Insurance Company undertook to inspect its insured's nightclub to assess risks of harm not to the business, not to the building, not to its equipment or contents but to third-party patrons. That service was not even performed to evaluate the risk for purposes of issuing the policy.[15] Clearly, Essex should have recognized that proper performance of such inspection "[w]as necessary for the protection of third persons," the Station's patrons. The insured, Michael Derderian, accompanied Essex' inspector through the inspection and was provided a report with written

[15] The policy's term was over half expired at the time of the inspection. The policy ran from March 24, 2002 to March 24, 2003. The inspection took place on October 8, 2002.

"recommendations" by the inspector, on which he reasonably relied, undertaking no further inspections on his own, to Plaintiffs' knowledge, from the date of Essex' inspection, October 8, 2002, to the date of the fire, February 20, 2003.

Several courts have applied §324A to find a duty owed to injured third parties on similar facts. In *Hill v. U.S. Fidelity and Guaranty Co.*, 428 F.2d 112 (5th Cir. 1970), cert. denied 400 U.S. 1008, 27 L.Ed. 2d 621, 91 S.Ct. 564 (1971), the United States Court of Appeals for the Fifth Circuit found that under Florida law the defendant liability insurer inspected its insured's hotel to detect conditions hazardous to hotel guests. The insurance company made reports of inspections to the insured with recommendations for the elimination of hazardous conditions, upon which reports the insured relied. Concluding that under Florida law these facts stated a claim on which relief could be granted, the Fifth Circuit considered the "point of entry for discussion" to be §324A of the Restatement of Torts, 2d (1965). The *Hill* court made it clear that these facts satisfied subsection (c) of §324A, quoting comment (e) to that subsection:

> (e) **Reliance.** The actor is also subject to liability to a third person where the harm is suffered because of the reliance of the other for whom he undertakes to render the services, or of the third person himself, upon his undertaking. This is true whether or not the negligence of the actor has created any new risk or increased an existing one. Where the reliance of the other, or of the third person, has induced him to forego other remedies or precautions against such a risk, the harm results from the negligence as fully as if the actor had

created the risk.

428 F.2d at 116.

The *Hill* decision by the Fifth Circuit was followed by a line of cases commencing with *Sims v. American Casualty Co.*, 131 Ga. App. 461, 206 S.E.2d 121, approved *sub nom. Providence Washington Insurance Co. v. Sims*, 232 Ga. 787, 209 S.E.2d 61 (1974). In *Sims*, the plaintiff's decedent was killed in a workplace fire. The plaintiff sued several insurance carriers for the employer, including liability insurance carriers (but excluding workers' compensation carriers). In this case Georgia analyzed whether a liability insurance company may incur common law tort liability to an insured's employees for negligence in the performance of safety inspections under Restatement §324A. The Georgia intermediate appellate court (later upheld by the Supreme Court of Georgia) denied the defendant's motion to dismiss for failure to state a claim, citing *Hill, supra*, and pre-Restatement cases such as *Nelson v. Union Wire Rope Corp.*, 31 Ill. 2d 69, 199 N.E.2d 769 (1964). It noted that "it is axiomatic that every person owes to all others a duty to exercise ordinary care to guard against injury which flows as a reasonably probable and foreseeable consequence of his act, and that such duty does not depend upon contract, privity of interest or the proximity of relationship, but extends to remote an unknown person." 206 S.E.2d at 129.

The *Sims* court conceded that under Georgia law, as in Rhode Island, a workers' compensation insurer enjoys the employer's immunity. 206 S.E.2d at 130. However, just as the Rhode Island General Assembly refused to cloak liability insurers in the mantle of insurance inspection immunity conferred by R.I.G.L. §27-8-15, Georgia's Supreme Court could not find a legislative enactment directing that the plaintiff's common law rights under §324A be abrogated:

> When defendants ask, as they do here, that plaintiff's common law right of action for negligence be abrogated, they must be prepared to show legislative enactment or other compelling authority for the result desired by them. Here, they have shown none.

206 S.E.2d at 131. The *Sims* court concluded,

> We recognize a common law tort duty as applicable to the making of safety inspections by these companies, and we find nothing in our state workers' compensation scheme nor in our judicial authorities which would insulate these defendants from suit as third party tortfeasors.

206 S.E. 2d at 133. The *Sims* opinion recognized that at the 12(b)(6) procedural juncture it could say nothing of the likelihood of plaintiff's success at trial.

> Whether any or all of these defendants made inspections; whether inspections were contractual or gratuitous; whether they were made for the insurance companies' internal rating purposes or for safety or for other purposes; whether the inspections were relied upon either by [the insured] or by deceased; whether the inspections were actually negligent – all of these points may influence the result in the trial court, and we address none of them.

Id. However, that is exactly our situation in the case at bar. Grant of Essex' 12 (b)(6) motion requires a finding that plaintiffs could prove no conceivable set of facts supportive of liability. This is a high burden, indeed, for Essex to satisfy, especially before any discovery has taken place.

Sims' reasoning and rationale were reinforced in *Universal Underwriters Insurance Co. v. Smith*, 253 Ga. 588, 322 S.E.2d 269 (1984). Responding to a question certified to it by the United States Court of Appeals for the Eleventh Circuit, the George Supreme Court held in *Universal Underwriters* that an employee who was injured by a defective air hose could demonstrate reliance on safety inspections performed by his employer's insurance company by explaining that he continued to use the air hose with confidence after witnessing inspections by the defendants. Noting that in *Huggins v. Aetna Casualty and Surety*, 245 Ga. 248, 264 S.E.2d 191 (1980), the court had expressly adopted §324A as the law of Georgia, the *Universal Underwriters* opinion, like the Fifth Circuit's opinion in *Hill, supra*, quotes comment (e) to the Restatement on "reliance". The opinion concludes that

> use by a third person of a defective instrumentality, whether it be a vehicle, an elevator, a machine or an air hose, in the manner in which such instrumentality is customarily used, where the fact of inspection is known to the third person but the defect is unknown, demonstrates reliance by the third person upon the defendant's safety inspection.

322 S.E.2d at 272.

In the case at bar, patrons of the Station nightclub were obviously unaware of Defendant Essex' inspections; however, the insured, Michael

Derderian, was acutely aware of the inspection, having participated in it and received its scanty "recommendations." He undertook no further inspections corrections on his own, but continued his business, as usual.[16] As explained in *Universal Underwriters*, "where liability is based on negligent safety inspections, reliance typically will be demonstrated by continuation of business as usual in the belief that any necessary precautions would be taken or called to the user's attention." 253 Ga. at 592; 322 S.E.2d at 273.

As in *Hill*, *Sims* and those cases' progeny, application of 324A to a liability insurer who negligently inspected its insured's premises for potential hazards to third parties, who furnished written recommendations to its insured (upon which the insured, privy to the inspection process and report likely relied), and whose negligence foreseeably resulted in the deaths of 100 of its insured's business patrons is completely consistent with Rhode Island's public policy of immunizing (only) fire/casualty insurers and workers' compensation insurers for negligent inspections. Indeed, the omission of liability insurers from Rhode Island's statutory immunity scheme bespeaks a legislative intent that the common law embodied in 324A apply to them, and them alone, among insurers – this, because of the eminent foreseeability of harm to third parties when issuers of third-party liability insurance are egregiously negligent.

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[16] Reliance by either the insured or the injured third party is sufficient under §324A. *Huggins, supra*.

3. Reliance By The Insured Guts Defendant's Argument That Negligent Inspections Are Better Than None At All

Throughout the Defendant's Memorandum are sprinkled dire predictions that if the common law of Rhode Island recognizes liability of shoddy insurance inspectors to foreseeably injured third parties, insurers may choose to perform no inspections at all. Putting aside the extreme unlikelihood that any liability carrier would underwrite completely unknown risks, where an insured has relied upon a negligent liability insurance inspection (by performing no further inspections on its own and making no safety improvements beyond those explicitly recommended) the general public is in greater peril than if no inspection had ever been performed by the insurer. The truth of this observation was recognized by the Supreme Court of Georgia in *Sims*, *supra*, when it opined, "[W]e cannot recommend negligent safety inspections as better than none at all." 206 S.E. 2d at 130.

Does Essex seriously contend that the Station's hundreds of dead and maimed patrons would have been worse off with no insurance inspection than with the myopic "recommendations" contained in their inspector's report? To ask the question is to answer it.

Moreover, where an insured has relied upon its liability insurer's faulty inspections, it will undoubtedly assert that reliance as a defense to its own liability – potentially exculpating itself in its own case. If a third-party claim against the negligent liability insurer/inspector is barred, the plaintiff could

be caught in a Catch-22: the only really culpable party would be immune from suit.[17]

4. Essex' Unilateral Declaration Of Intent Cannot Insulate Itself from 324A

After arguing that 324A requires actual intent of an insurer to assume the duties of the insured (which is only required under subsection (b) of 324A, not subsection (c)), the defendant relies on one line buried in its insurance policy which states that Essex "*does not undertake to perform the duty of any person or organization to provide for the health and safety of workers or the public.*" Beyond the fact that such claimed lack of intent bears only on 324A(b) claims, as opposed to 324A(c) claims like the case at bar, and beyond the obvious fact that the report and recommendations of Defendant's inspector to the insured evidence a contrary intent (i.e., to protect patrons of the Station), 324A simply does not require actual intent by the inspector to benefit unknown third parties; rather, 324A speaks of rendering services "which he should recognize as necessary for the protection of a third person." As the Court of Appeals of Georgia explained in *Cleveland v. American Motorists Insurance Co.*, 163 Ga. App. 748, 295 S.E.2d 190 (1982),

[17] This harsh result illustrates why liability insurers have exposure under 324A, but workers' compensation carriers do not. In a liability situation the plaintiff must satisfy a burden of proof as to the insured's negligence (which the insured might defeat by showing reasonable reliance upon its insurer's inspections). In workers' compensation, the insured's liability is strict.

> The record in this case reveals some evidence of reliance on the part of [the insured] Georgia Power Company. . . . One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to [perform] his undertaking.

295 S.E.2d at 193-94 (emphasis original). Rejecting the defendant's argument that a unilateral policy declaration can defeat 324A in the face of foreseeability and reliance, the *Cleveland* court held:

> We do not interpret *Sims* and its progeny as permitting an insurer summarily to extract itself from the realm of negligent inspection actions brought by non-parties to the insurance contract merely by inserting into the insurance contract a clause stating that the inspections are being undertaken solely for risk management or other internal purposes.

295 S.E.2d at 193.

Victims of the Station fire would be surprised, indeed, to learn that one line in an insurance policy of which they could have had no knowledge would deprive their survivors of a remedy against one who negligently performed an inspection of the club (for the very purpose of identifying hazards to them), and who made an inadequate recommendation to the club's owner (who, in turn, relied on it to their fatal detriment). Just as exculpatory agreements between parties of unequal bargaining power are considered to be against public policy in most jurisdictions, *17A AmJur 2d Contracts §284*, so must a liability insurer's self-serving policy insertion prove ineffective to

"summarily extract itself from the realm of negligent inspection actions brought by non-parties to the insurance contract." *Cleveland, supra.*

C. Restatement §324A, As Applied To Liability Insurers, Creates No Conflict Between Insurers And Their Insureds

Defendant Essex asserts in its Memorandum at 13 that for Rhode Island to embrace 324A on the facts of this case would "directly contradict the bedrock duties of an insurer in Rhode Island to its policyholders." In support of this proposition Essex cites nothing but third-party bad faith claims-adjusting cases.[18] Such cases, however, are completely inapposite. In order to avoid a third-party bad faith adjusting claim (if it were to be permitted by the courts), an insurer might, conceivably, temper its vigorous defense of its insured – an obvious conflict.

In the instant case, however, no such conflict arises. The gravamen of the offense here are acts and omissions (negligent inspections) by an insurer which tend to expose its insured to liability. To the extent that liability insurers may seek to avoid liability by inspecting with more care, they serve both their insureds' and their own interests. Indeed, competent liability hazard inspections serve the insurer, the insured and the general public, alike. Encouraging them constitutes the soundest of public policies.

---

[18] *Theriot v. Midland Risk Ins. Co.*, 694 S.2d 184 (La. 1997), *Canavan v. Lovett, Schefrin and Harnett*, 745 A.2d 173 (R.I. 2000), *Elmore v. State Farm Mut. Auto. Ins. Co.*, 504 S.E.2d 893 (W.Va. 1998), *Larocque v. State Farm Ins. Co.*, 660 A.2d 286 (Vt. 1995) and *Dvorak v. American Family Mut. Ins.* Co., 508 N.W.2d 329 (N.D. 1993), all relied upon by Defendant for its "conflict of interest" argument, are all cases in which a third party attempted to sue an insurer for bad faith in adjusting claims arising solely from negligence of its insured. In the case at bar liability of Essex arises from negligence of the insurer.

Stepping back, all of Defendant's arguments boil down to the following flawed extrapolation:

- There are certain situations in which the law of Rhode Island chooses not to allow suits by injured third parties directly against insurance companies (i.e., workers' compensation insurer; property/casualty insurer who is not primarily interested in avoiding harm to third parties; third-party bad faith claims-adjusting suit).

- Therefore, actions against any kind of insurer by a third party (regardless of culpability, reliance or causative link to a tragedy of historic proportion) must be barred.

Unfortunately, this approach blinks the question of why the Rhode Island legislature chose to carve out liability insurers from §27-8-15, the insurance inspection immunity statute. This question is answered by the Rhode Island courts' embrace of Restatement Torts 2d §324A in *Buszta* and *Dixon, supra*. Rhode Island's legislative scheme makes it clear that the public policy of Rhode Island disfavors immunizing liability insurers in §324A situations.

IV. STANDARD OF REVIEW

As mentioned earlier, Defendant Essex' pending motion is one to dismiss pursuant to Fed.R.Civ.P. 12(b)(6). The standard for dismissal at this juncture – before any amendments of the Complaint have been allowed and before any discovery has been taken is, and well should be, a strict one. As enunciated by the United States Supreme Court in *Conley v. Gibson*, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed. 2d 80 (1957),

> In appraising the sufficiency of the complaint we follow, of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.

(recently applied by this Court in *Lacedra v. Donald W. Wyatt Detention Facility*, ____ F.Supp. 2d ____, 2004 WL 2030107 (D.R.I.)).

On the facts of this case it may hardly be said at this stage of the proceedings that Plaintiffs will not be able to prove any set of facts upon which liability under 324A may be premised. Accordingly, Defendant Essex' Motion to Dismiss should be denied.

V. PRAYER FOR RELIEF AND OPTIONAL CERTIFICATION OF QUESTION TO THE RHODE ISLAND SUPREME COURT

For the reasons set forth above, Plaintiffs respectfully submit that Rhode Island's legislative scheme (conferring inspection immunity on all but liability insurers) and caselaw embracing Restatement, Torts, 2d, 324A compel the conclusion that Plaintiffs' Complaint states a claim upon which relief may be granted. Should this Court seriously entertain Defendant Essex' Motion or deem Rhode Island law in this area to be unsettled, however, Plaintiffs would respectfully suggest that this Court allow ample discovery on §324A and other threshold issues, then consider certification of the following question to the Rhode Island Supreme Court pursuant to Rhode Island Supreme Court Rule of Appellate Procedure 6:

> Under Rhode Island's interpretation of §324A of the Restatement, Torts, 2d may a liability insurer who has negligently inspected its insured's premises, making written report and recommendations, be

liable to foreseeably injured patrons of the insured where the insured has relied upon such inspection and recommendations?

If this Court deems the above question to be one of first impression in Rhode Island, we would respectfully suggest that, in light of the unprecedented scope of the Station fire tragedy and its effect on hundreds of Rhode Island citizens, such certification might be appropriate to insure a correct and judicially efficient result in the instant litigation.

Respectfully submitted,

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CERTIFICATION

I hereby certify that an exact copy of the within document was mailed to the following individuals on this 30th day of September, 2004.

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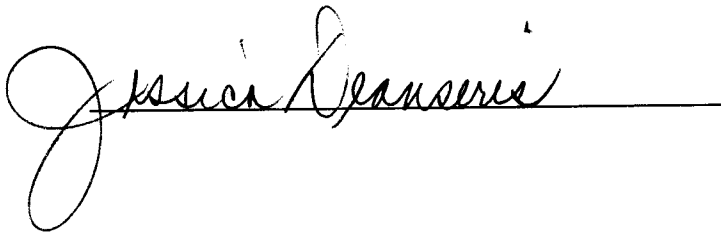
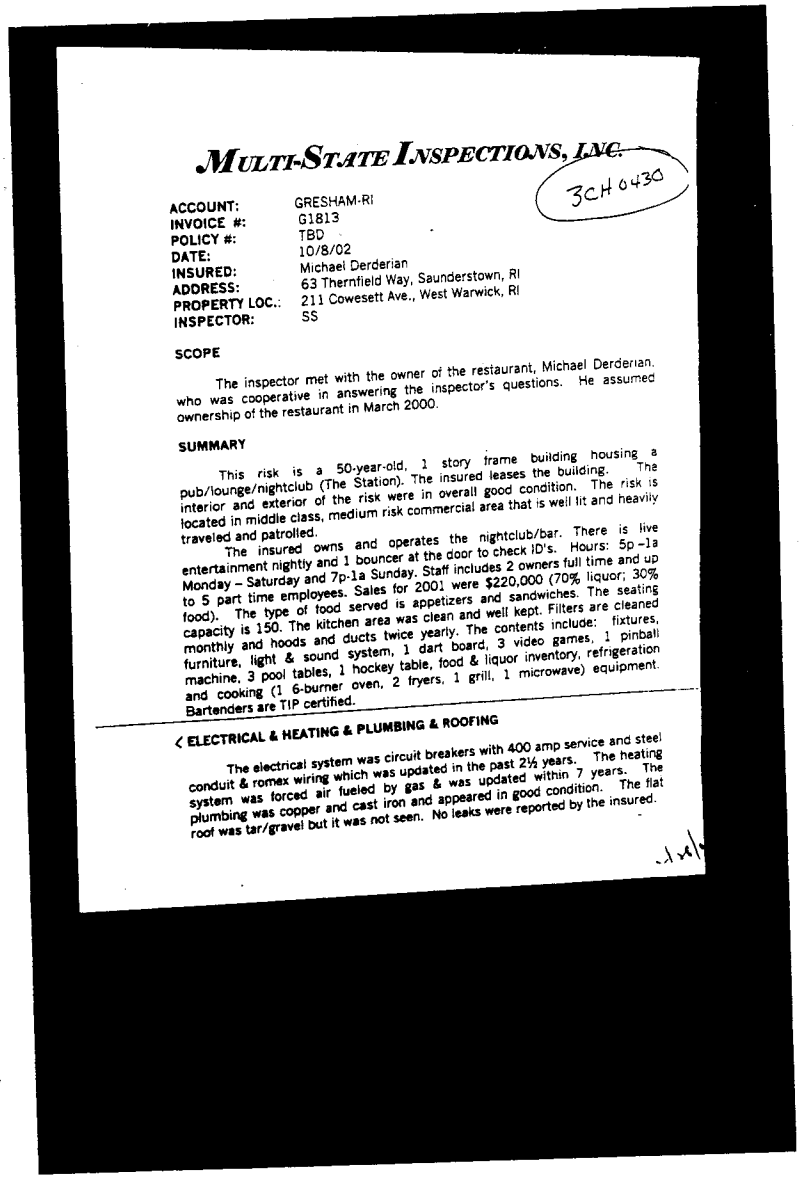




MULTI-STATE INSPECTIONS, INC.

3CH 0430

ACCOUNT: GRESHAM-RI
INVOICE #: G1813
POLICY #: TBD
DATE: 10/8/02
INSURED: Michael Derderian
ADDRESS: 63 Thernfield Way, Saunderstown, RI
PROPERTY LOC.: 211 Cowesett Ave., West Warwick, RI
INSPECTOR: SS

SCOPE

The inspector met with the owner of the restaurant, Michael Derderian, who was cooperative in answering the inspector's questions. He assumed ownership of the restaurant in March 2000.

SUMMARY

This risk is a 50-year-old, 1 story frame building housing a pub/lounge/nightclub (The Station). The insured leases the building. The interior and exterior of the risk were in overall good condition. The risk is located in middle class, medium risk commercial area that is well lit and heavily traveled and patrolled.

The insured owns and operates the nightclub/bar. There is live entertainment nightly and 1 bouncer at the door to check ID's. Hours: 5p-1a Monday – Saturday and 7p-1a Sunday. Staff includes 2 owners full time and up to 5 part time employees. Sales for 2001 were $220,000 (70% liquor; 30% food). The type of food served is appetizers and sandwiches. The seating capacity is 150. The kitchen area was clean and well kept. Filters are cleaned monthly and hoods and ducts twice yearly. The contents include: fixtures, furniture, light & sound system, 1 dart board, 3 video games, 1 pinball machine, 3 pool tables, 1 hockey table, food & liquor inventory, refrigeration and cooking (1 6-burner oven, 2 fryers, 1 grill, 1 microwave) equipment. Bartenders are TIP certified.

< ELECTRICAL & HEATING & PLUMBING & ROOFING

The electrical system was circuit breakers with 400 amp service and steel conduit & romex wiring which was updated in the past 2½ years. The heating system was forced air fueled by gas & was updated within 7 years. The plumbing was copper and cast iron and appeared in good condition. The flat roof was tar/gravel but it was not seen. No leaks were reported by the insured.

EXHIBIT A

MULTI-STATE INSPECTIONS, INC.

PROTECTION

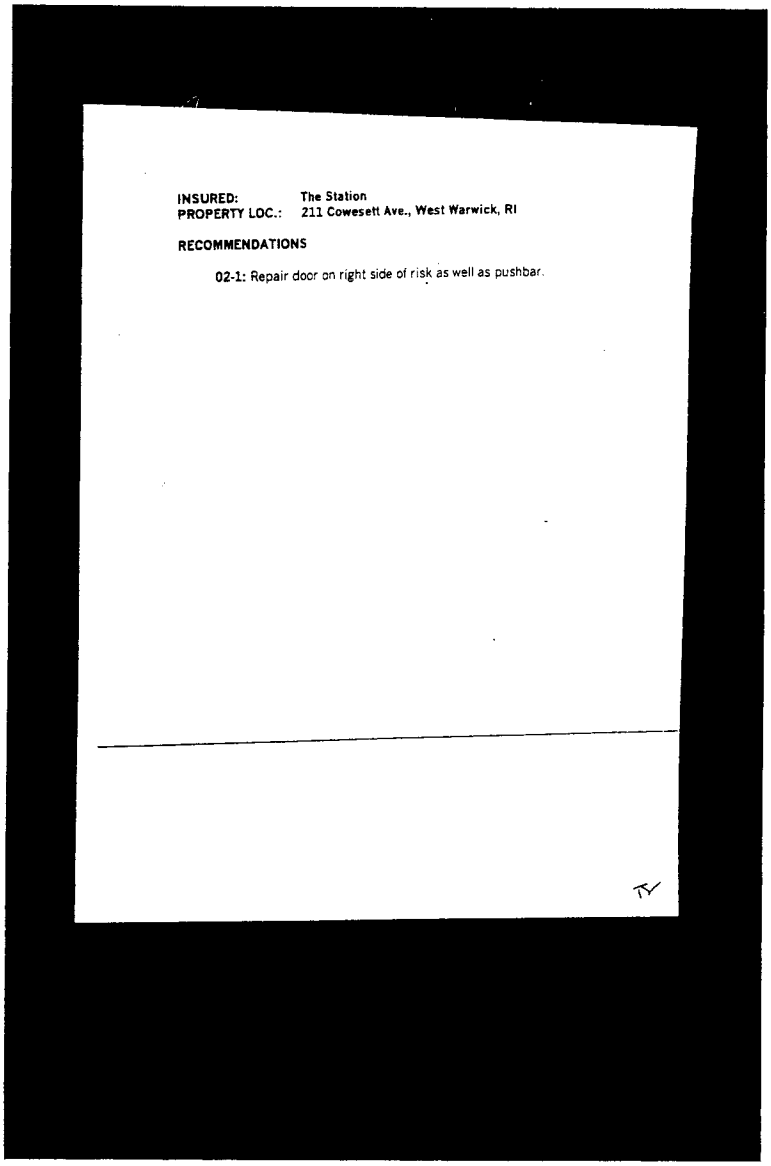
The risk is protected by the West Warwick Fire Department. The nearest fire station is within 2 miles and the nearest fire hydrant is with 250 feet of the risk. The risk also is equipped with hardwired heat/smoke detectors, central station fire and burglar alarms with pull boxes and motion sensors (monitored by SOS Alarms.), emergency lights, illuminated exit signs, a video system which records every night, pull box at street for fire department and a Pyro-Chem PCL-350 wet chem ansul system tagged 11/2001 by Coastal Fire & Safety.

LOSSES

None reported

EXPOSURES

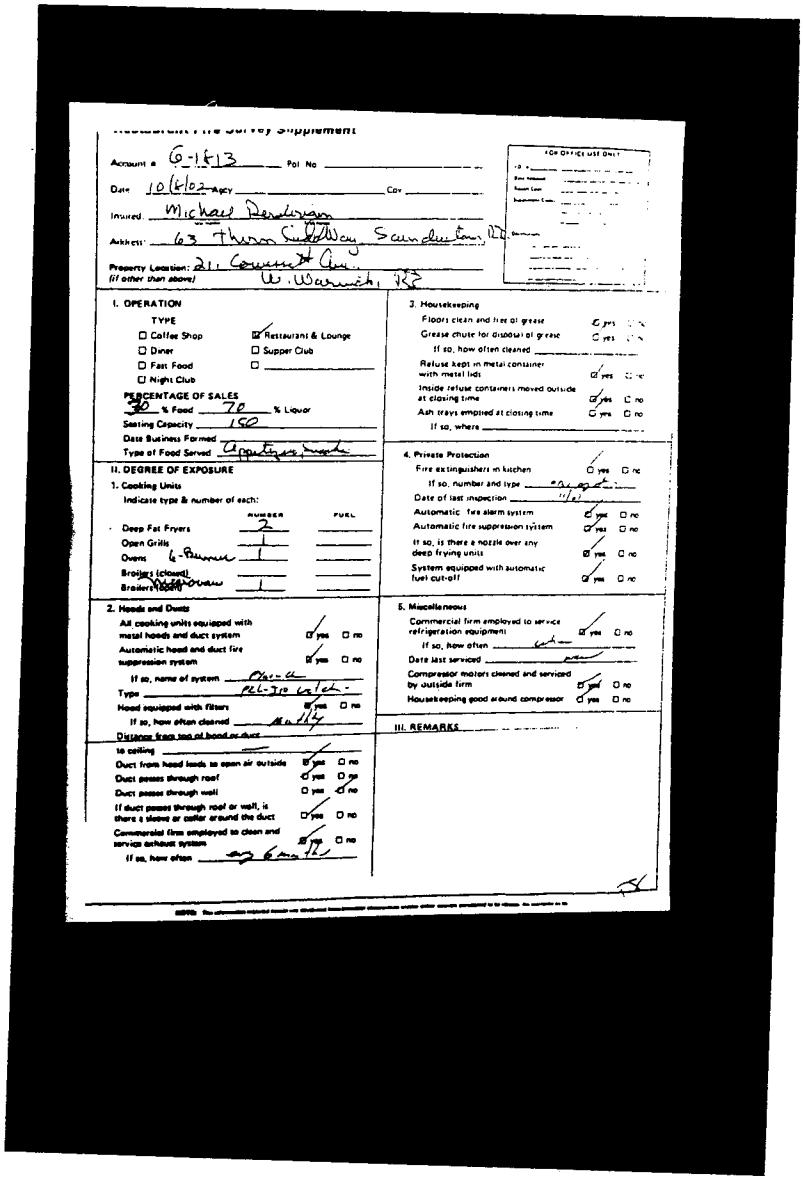
WATER: The risk is more than ½ mile from any major body of water.
FRONT: Parking Area (10,000 square feet)
SQUARE FOOTAGE: 4000



INSURED: The Station
PROPERTY LOC.: 211 Cowesett Ave., West Warwick, RI

RECOMMENDATIONS

02-1: Repair door on right side of risk as well as pushbar.



Restaurant Fire Survey Supplement

Account # G-1613 Pol No _____

Date 10/6/02 Agcy _____ Cov _____

Insured Michael Henderson

Address 63 Thurston Sandwich, RI

Property Location: 21 Convent Ave. W. Warwick, RI
(if other than above)

FOR OFFICE USE ONLY

I. OPERATION

TYPE

- ☐ Coffee Shop
- ☐ Diner
- ☐ Fast Food
- ☐ Night Club
- ☑ Restaurant & Lounge
- ☐ Supper Club
- ☐ _____

PERCENTAGE OF SALES

30 % Food 70 % Liquor

Seating Capacity 150

Date Business Formed _____

Type of Food Served Appetizers, Meals

II. DEGREE OF EXPOSURE

1. Cooking Units

Indicate type & number of each:

	NUMBER	FUEL
Deep Fat Fryers	2	
Open Grills	1	
Ovens 6-Burner	1	
Broilers (closed)		
Braiser/Hibachi	1	

2. Hoods and Ducts

All cooking units equipped with metal hoods and duct system ☑ yes ☐ no

Automatic hood and duct fire suppression system ☑ yes ☐ no

If so, name of system Ansul

Type Pre-Fire Wet Chem.

Hood equipped with filters ☑ yes ☐ no

If so, how often cleaned Monthly

Distance from top of hood or duct to ceiling _____

Duct from hood leads to open air outside ☑ yes ☐ no

Duct passes through roof ☑ yes ☐ no

Duct passes through wall ☐ yes ☑ no

If duct passes through roof or wall, is there a sleeve or collar around the duct ☐ yes ☐ no

Commercial firm employed to clean and service exhaust system ☑ yes ☐ no

If so, how often every 6 mos.

3. Housekeeping

Floors clean and free of grease ☑ yes ☐ no

Grease chute for disposal of grease ☐ yes ☐ no

If so, how often cleaned _____

Refuse kept in metal container with metal lids ☑ yes ☐ no

Inside refuse containers moved outside at closing time ☑ yes ☐ no

Ash trays emptied at closing time ☐ yes ☐ no

If so, where _____

4. Private Protection

Fire extinguishers in kitchen ☑ yes ☐ no

If so, number and type 2 Ansul

Date of last inspection 11/01

Automatic fire alarm system ☑ yes ☐ no

Automatic fire suppression system ☑ yes ☐ no

If so, is there a nozzle over any deep frying units ☑ yes ☐ no

System equipped with automatic fuel cut-off ☑ yes ☐ no

5. Miscellaneous

Commercial firm employed to service refrigeration equipment ☑ yes ☐ no

If so, how often Mo

Date last serviced 2002

Compressor motors cleaned and serviced by outside firm ☑ yes ☐ no

Housekeeping good around compressor ☑ yes ☐ no

III. REMARKS _____